FRT FINANCIAL RECOVERY TECHNOLOGIES

Financial Recovery Technologies' Submission in Response to "Inquiry into Class Action Proceedings and Third-Party Litigation Funders – Discussion Paper"

About FRT

Financial Recovery Technologies (FRT) is a leading technology-based services firm that helps institutional investors identify eligibility, file claims and collect funds made available in securities class action settlements and litigations impacting global investors. Offering the most comprehensive range of services, we provide best-in-class eligibility analysis, disbursement auditing and client reporting.

- **Claims Filing**: Identify eligibility, file claims and collect funds made available in U.S. securities class action settlements.
- **Global Group Litigation**: Identify and monitor non-U.S. securities litigation to make timely participation decisions.
- **Antitrust**: Access insight and case participation assistance into Antitrust, Commodity Exchange Act and non-securities based litigations.
- **Litigation Monitoring**: Access real-time securities class action information to make independent, timely participation and lead-plaintiff decisions.
- **Buyouts**: Monetize the value of a liquidating fund's class action claims.

We deliver the highest level of accuracy, accountability and transparency available to a wide range of institutional investors including world's leading sovereign wealth funds, global banks, custodians, Australian Super funds, pension funds, global investment managers and individual investors. Financial Recovery Technologies is a Cross Country Group company (www.crosscountrygroup.com). For more information, go to www.frtservices.com or email learnmore@frtservices.com.

Comments on Proposal 1-1

The ALRC Report recommends the Australian Government commission a review of the legal and economic impact of statutory continuous disclosure obligations on securities issuers, and that it consider restricting or eliminating them due to concerns that issuers are being unfairly targeted by 'strike suits' manufactured by profit seeking plaintiff securities class action lawyers and third-party funders. The Report also expresses concern that these suits are depressing share prices and imposing an unfair cost on current investors, some of whom may also be class members; and concern that a recent surge in the number of class action filings and settlements is destroying the D&O insurance market and causing issuers to consider relocating offshore.

Unlike other parts of the Report, there is little legal or factual discussion around this Proposal, particularly its second and third prongs. Rather, the Proposal is grounded on biased rhetoric and misperceptions about how cases get started. The discussion ignores many safeguards in the Australian legal system which will deter the filing of baseless securities class actions. In short, the Proposal seems to articulate a desire for sweeping changes in need of studies to justify them, rather than the other way around.

In this submission, we address each of the three prongs in Proposal 1-1, offering anecdotal and factual data refuting many of its assumptions and conclusions, and suggest other explanations for perceived trends. In doing so, we hope to give the Australian Government, and any reviewers retained to study

issues surrounding the Proposal, an alternative and more balanced perspective of the current securities class action landscape.

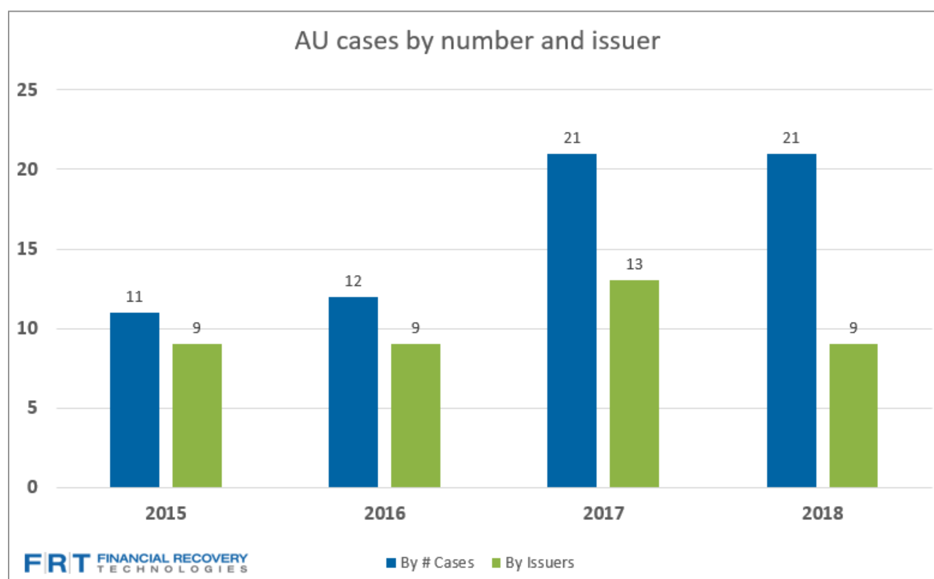
Proposal 1-1: The Australian Government should commission a review of the legal and economic impact of the continuous disclosure obligation of entities listed on public stock exchanges and those relating to misleading and deceptive conduct contained in the *Corporations Act 2001* (Cth) and the *Australian Securities and Investments Commission Action 2001* (Cth) with regards to:

- ***"the propensity for corporate entities to the be the target of funded shareholder class actions in Australia;"***

1. The frequency of shareholder class actions does not suggest a crisis: On page 28, the Report notes that since passage of the *Corporations Act* in 2001, "66 actions have been filed in the Federal Court." This equates to an average 4 per year (66 cases/16 years), hardly a crisis level. While citing a rise in the number of securities class actions as the basis for potential curtailment of continuous disclosure obligations, the Report fails to offer any year-to-year metrics on case filings. Rather, it cites statistics that include *other* types of class actions, which do not support reforming statutes that apply only in the securities area.

   For figures given, the Report separately counts each class action against an issuer. The more relevant figure is the number of *issuers* that have been sued because, as the Report notes elsewhere, courts typically consolidate securities class actions against the same issuer and are increasingly selecting one case to proceed while staying all others. For example, on page 32, the Report notes three suits against *GetSwift* and five against *AMP*. Counting the number of cases filed (8) rather than the number of issuers sued (2) overstates things fourfold and gives the misimpression of higher levels.

   Below are filing metrics from 2015 to date. Counting matters by issuer rather than by the number of filings, per year levels are not high and there hasn't been a 'spike' justifying broad reforms to statutory rights.



2. <u>The growing number of law firms and funders does not suggest a crisis</u>: The Report notes as problematic the increased number of law firms and funders (collectively, Organizers) involved in securities class actions. *See e.g.* Report, pp. 16-17; 41-42. However, there is no indication that more Organizers have resulted in more issuers being sued. Rather, these Organizers are suing the same limited number of bad actors. *See* Report at 102 ("The majority of competing class actions over the last five years have been shareholder matters.").

   While the number of law firms prosecuting securities class actions has grown modestly, some of this reflects partners leaving their firms to start new ones. For example, in mid-2017, Ben Phi and two others left Slater & Gordon to start Phi Finney McDonald. Other existing law firms have expanded their practices in the securities area. Yet there are still only a handful of firms active in this area.

   While the number of funders has increased, this has had a beneficial rather than detrimental impact. Funders allow investors to participate on a no-win, no-fee basis and many institutional investors would not register for cases absent the ability to participate on such terms. The additional competition has significantly reduced percentage success fees charged by funders, greatly benefiting investors. Courts have accelerated this trend by expressing a preference during the Organizer selection process for those offering better terms of representation to the class.

   Perversely, the greater number of organizers sometimes benefits issuers by making it harder to sue them. Third party funders make their financial commitments contingent on a sufficient amount of class members and losses joining their efforts. This is necessary to make the litigation economically viable. As the finite pool of eligible claimants - and particularly institutional investors with larger losses - gets divided among more Organizers, each has a harder time meeting their funding thresholds, resulting in longer book builds and in some cases, failures to file.

   Finally, the continued trend of courts choosing one law firm, one funder, and one proceeding to continue while staying all others has the natural consequence of raising entry costs. In any given action, those Organizers not selected lose the time and money spent during their book builds, which discourages future efforts. Combined with the pressure of lower fees and profits, this can be expected to reduce the number of active third-party funders over time. And if (or when) Australian lawyers are permitted to represent clients on a fully contingent basis, the number of funders will fall further. In other words, the 'problem' cited in the Report is likely to resolve itself over time without the need for wholesale statutory reforms that abrogate shareholder rights.

3. <u>The frequency and size of settlements do not suggest a crisis</u>: As the Report itself notes, at pp. 36-37, amounts 'ordered' by courts in these cases reflect the approval of settlements voluntarily entered into by issuers after mediation. Standing alone, neither the number nor size of settlements suggests the underlying cases lack merit. Quite the opposite, the idea that issuers willingly pay tens of millions of dollars - and in some cases more than $100 million - to avoid trying what they believe are fundamentally flawed or weak cases strains credulity. The Report cites as motivation to settle the uncertainty of going to trial given limited judicial decisions on issues including "the validity of the 'market-based causation' theory …" Report, at 28. However, the risk associated with an absence of legal precedent cuts both ways and does not explain either the frequency or size of settlements.

On average, Australian securities class actions can recover roughly 35% to 50% of registrant losses, a much higher figure than in the US where cases frequently settle for percentages in the single digits. This further confirms the merits of these matters.

In short, the Report fails to acknowledge the most likely reason securities class actions settle often and for substantial amounts: both parties understand the underlying claims have merit and the risks attendant to proceeding further. *See e.g.* Report at 32 (suggesting many reasons for frequent settlements but fails to admit merit as a possibility).

4. The Report misconstrues how securities class actions get started: Conspicuously absent from the Report are *any* detailed examples of baseless suits. If prevalent enough to justify fundamental changes to issuer disclosure obligations, the Report would presumably offer at least one instance of a demonstrably frivolous matter. Instead, all the Report gives is a false narrative on how these actions get started. On page 30, for example, the Report describes the "standard approach to the development of securities class actions" as follows: the securities class action lawyers and their experts monitor ASX for significant price drops and then work backwards to see if they can find false representations or material omissions. If they do and the associated share price and volume impacts appear significant, they file suits.

   In reality, securities class actions come in the wake of substantial business scandals revealed by the business press and/or securities regulators. AMP is a good example. That scandal broke when, on April 16, 2018, *Reuters* (and others) broke the news that "Australia's AMP misled corporate watchdog for almost a decade: inquiry hears."

   Having reviewed all AU securities class actions since 2015, we can find no instance where the underlying corporate misconduct was first brought to public attention by the plaintiff bar. Rather, the suits follow the scandals.

5. The legal system has built-in protections against strike suits: The Report's false narrative on how suits originate also disregards protections inherent in the Australian shareholder litigation system that prevent strike suits, as well as court procedures that instead of promoting too many suits systematically *understate* the full harm to class members from corporate wrongdoing. In other words, rather than imposing too much liability for corporate malfeasance, the current system likely imposes *too little* responsibility on bad actors.

   In Australia, unlike the US, there are no instances where shareholders file suit within hours or days of revelation of corporate wrongdoing. Bad cases make bad investments, and Organizers consider potential matters for some time before making a final decision to invest time and resources in litigation. While the trend towards filing 'open classes' has shortened the time to file, the book-build process still takes months to complete, during which time subsequent events are incorporated in their analyses. For example, stock price rebounds can deter cases as defendants use them in defense of claims.

   Even after Organizers decide specific matters have merit, they still need a sufficient number of investors with substantial losses to join their group in order to trigger funding commitments. Unlike the US, Australia also has adverse party cost shifting, exacting a penalty for frivolous actions. As noted in the Report, the 'After the Event' (ATE) insurance market has grown significantly in recent years and such insurance is readily available. If frivolous cases were the norm, this insurance market

would be shrinking with less coverage and higher premiums. Nothing in the Report suggests this has happened.

Judges can be relied upon to dismiss legally insufficient claims. The Report cites a healthy 36% rate of non-settlement dispositions. *See* Report, at p. 41 (noting that 64% of securities cases settle). The settlement rate for shareholder class actions is *less* than that for investor class actions and mass tort cases. *Id.* Yet the Report does not advocate curtailing the underlying causes of action in these areas.

If anything, the registration requirement systematically *undervalues* actual harm to the class as some investors do not end up registering their claims before the deadline and are therefore not eligible to participate in later settlements or other recoveries. Unlike the US, where settlements are negotiated against the estimated full harm to *all* class members (as modeled by experts), in Australia settlements are limited to the harm to those class members who take the prior step of registering claims before mediations.

Courts close cases to further registrations before mediation and trial, barring those who fail to join from future settlements. *See* Report, at p. 109 ("The ALRC considers that there is merit in providing for class closure at mediation to be final so that the potential for the class to re-open is not used for tactical advantage."). As a result, both sides go into mediations aware of the range of potential damages suffered by eligible (registered) class members. This explains the higher percentage recovery rates.

In short, nothing in the Report supports the assertion that frivolous claims or strike suits are a problem in Australia, or that if they were the courts cannot be relied upon to deal with them. Wholesale revisions to underlying disclosures obligations are not necessary to solve problems that do not exist.

- ***"the value of the investments of shareholders of the corporate entity at the time when the entity is the target of the class action;"***

  This second prong of the Proposal suggests that investor claim rights should be curtailed given the depressant effect that securities class actions purportedly have on the issuers' stock prices. The inference is that the interests of current equity holders outweigh those of previously harmed investors in the class, and that this argument is more compelling if there a high rate of overlap between the two groups exists. The Report offers no factual basis for either assertion.

1. <u>Share prices respond to the underlying corporate misconduct, not the filing of class suits</u>: Adverse share price movements follow in the wake of public revelations of corporate misconduct, not announced investigations by class action lawyers or their eventual filings. Why? Because unlike the US, where suits are routinely filed shortly after announced corporate malfeasance, in Australia there is always a long gap related to the book build process, which can go on for months before suits get filed.

   The Report itself equivocates on the possible impact of shareholder class actions on stock prices. On page 30, for example, the Report says that "[d]uring this development stage an announcement *might* be made of a potential class action, attracting media attention which *may* augment the

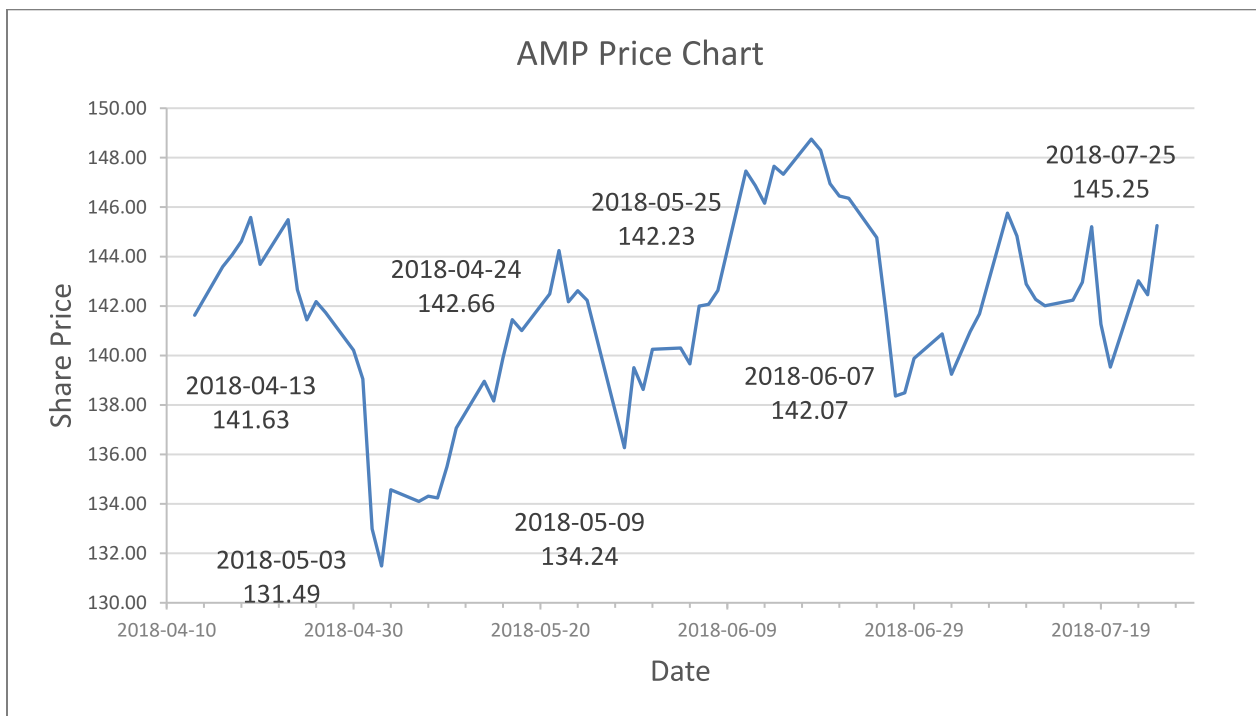
number of affected shareholders who wish to participate in the proposed class action, but which *may* also precipitate a further decline in the price of the securities." (Emphasis added).

The Report does not cite any data supporting the proposition that law firm investigations or filings depress the stock prices beyond that resulting from the underlying corporate malfeasance. In many matters, for competitive advantage during the book build process, Organizers will try to keep details of their efforts circumspect and do *not* publicly share the status of their book building efforts or expected timing of filings. Announcements, if any, are very limited and thus cannot cause persistent price depressions, as the Report suggests.

The Report cites as 'abusive' the five suits filed against AMP. *See, e.g.* Report, p. 32, footnote 81. To date, the following Organizers have filed suits against the company and related defendants:

Law Firm	Date Filed	Class Period Start	Class Period End
QUINN EMMANUEL	5/9/2018	5/10/2012	4/15/2018
PHI FINNEY	5/9/2018	5/6/2013	4/13/2018
SHINE LAWYERS	5/25/2018	5/23/2013	6/7/2019
SLATER & GORDON	6/7/2018	6/7/2012	4/15/2018
MAURICE BLACKBURN	6/7/2018	5/26/2015	4/13/2018

The chart below shows AMP stock prices from April 13, 2018 (the day before the *Reuters* story) through July 25, 2018. During the second half of April, as AMP's misconduct came to light, AMP's stock price slid from $142.18 on April 26, 2018, to a low of $131.49 on May 3, 2018. Since then, the stock has rebounded, closing at $148.75 per share, higher than pre-disclosure levels on June 18, 2018. As of July 25, 2018, AMP stock is trading at or above its price on April 16, 2018.



Between April 24 and May 3, 2018, various news outlets reported generally on law firm 'investigations' and the possibility of class action filings. However, the Report fails to make any effort to separate the effects of these 'investigation' announcements from the impact of the scandal itself. Whatever marginal impact they may have had, it was certainly not long lived. AMP stock rebounded thereafter, and when the actual filings occurred, they did not have any impact on share prices.

- On May 9, 2018, the Litigation Finance Journal ran a story entitled "Backed by IMF Bentham, Phi Finney Launches Class Action Against AMP." That same day, Quinn Emmanuel also filed suit. AMP stock closed at effectively the same price as the day before.

- On May 25, 2018, when Shine Lawyers filed their action, AMP closed at effectively the same price as the day before.

- On June 7, 2018, when both Maurice Blackburn and Slater & Gordon filed class actions, AMP closed slightly up from the day before.

In short, any depression in AMP stock price resulted primarily from public revelation of the company's misdeeds. Whatever marginal impact followed news stories about law firm 'investigations' was short-lived at worst, as shown by the fact that the subsequent filings after book building did not move share prices at all. In fact, on one of the three days, share prices closed slightly higher. Contrary to claims made in the Report, there is no persistent overhang on share prices caused by securities class actions.

2. <u>There is limited overlap between current investors and harmed class members</u>: The Report suggests an argument for curtailing shareholder rights is stronger if there is significant overlap between current investors and class members. Class members who still retain their share have an interest in avoiding the purported depressing effects of lawsuits and eventual settlement payments, despite the fact that more than half settlement funds come from D&O insurance.

   The Report does not offer any statistical support for this assertion and given the way share registries are kept, it's likely impossible to determine the actual overlap. However, the odds are against it being significant given the lengthy time gap between class periods and events underlying claims and the later filing and eventual settlements of matters.

   Let's again consider AMP. The company has 144.6 million shares outstanding. The table above shows the class periods for each of the five filed actions, which start as early as June 7, 2012, more than six years ago. With AMP's average <u>*daily*</u> trading volume exceeding 1 million shares over these years, the likelihood of a significant overlap between today's AMP investors and those during the class period is remote and shrinking each day. The overlap will be even less if the matter settles down the road, particularly given that the cases were recently filed and the average life cycle for securities class actions is about two years from filing to resolution.

- ***"the availability and cost of directors and officers liability insurance within the Australian market."***

  The Report notes that "there has been chronic underpricing of D&O business by insurers since at least 2011." It also notes that "the current [2018] D&O market premium pool is thoroughly

inadequate to meet the current and projected levels of insured securities class action losses" and that "the cost of D&O insurance has increased more than 200% in the last 12 to 18 months." *See* Report, p. 30. The Report says one carrier has left the market, cites anecdotal indications the market is hardening, and mentions an unnamed company that may be thinking about moving offshore. *Id.*

Persistent mispricing by D&O carriers does not justify curtailing shareholder rights. The Report offers little detail on the reasons for the claimed crisis in the D&O market. Even assuming a crisis exists, it's hard to put this on passage of the Acts which occurred more than a decade earlier. Certainly, D&O carriers have had ample time to get their pricing house in order. Their failure to do so should not result in punishing shareholders who are victims of the underlying misconduct being insured.

Even assuming risk mispricing results from recent filings and/or settlement payouts, Proposal 1-1 would be analogous to the government, in an effort to protect insurers, downgrading storm levels after the fact or passing laws saying that no storms can be categorized as hurricanes for purposes of coverage. Essentially, this is what the Report seeks when, on page 32, it says "The Productivity Commission suggested that 'public debate' about the underlying law was more appropriate than changing the mechanism by which class actions were prosecuted. The ALRC agrees with the Productivity Commission."

Conclusion

Curtailing shareholder rights may seem like an expedient way to insulate companies from liability for their misdeeds and to prop-up failing D&O carriers who have for many years mispriced risk. However, the impairment of investor rights and erosion of transparency and trust in the Australian securities markets will cause greater economic harm in the long term.

In sum, the Australian Government should require more information and findings from ALRC before recommending a review aimed at fundamental changes to shareholder rights. If commissioned, the Government should ensure the proposals and studies sought are framed in ways that are balanced and do not suggest a desired end result, as the Report does in Proposal 1-1.